A CRITIQUE OF
Böhm-BawerkS REASONING
IN SUPPORT OF
HIS TIME PREFERENCE THEORY

by
Ludwig von Mises

This is the critical analysis to which Mises refers in Human Action, 3rd ed. page 488, note 5 (Chicago: Regnery, 1966). It appeared in National?konomie (Geneva, Switzerland: Editions Union, 1940), pp. 439-444. This excerpt has been translated from the German by Bettina Bien Greaves and edited by Percy L. Greaves, Jr.

In order to appreciate this critique, it is important to realize that, while Mises gave Böhm-Bawerk full credit for his important analysis of the phenomena of interest, he pointed out here that Böhm-Bawerk failed to understand why present goods regularly attain a higher value than physically identical future goods do, i.e., the sole cause giving rise to the phenomenon of interest. Mises went on to explain in National?konomie, as he does in Chapter XVIII of Human Action (1949/1963/1966), that time preference is an inherent category of human action. For the same reason that "a bird in the hand is worth two in the bush," present goods are worth more than the identical items in an uncertain future. Present goods are more valuable than future goods, not because of some psychological factor or personal value judgment of particular persons at particular times and places?but simply because the present goods are available here and now and the future goods are not. Thus, interest is a praxeological consequence of man's cognition of time. Individuals are bound by the limitations of the universe and the very nature of man with his a priori or innate awareness of time to place a lower value on future goods than they do on present goods. However, to call this lower valuation an UNDER?valuation, as Böhm-Bawerk did, is a judgment of value and not a scientific statement.
BBG & PLG.

B?hm's Theory Based on Psychology

In his trail-blazing inquiry into the problem of interest, Böhm-Bawerk starts with the assertion that present goods are in every instance more valuable than future goods of the same kind and quantity.[1]He then attempts in two different ways to prove this theory on psychological grounds.

The second reason[2] offered by Böhm-Bawerk for the higher valuation of present goods as compared with future goods is that future needs and the means available for satisfying them are regularly, but incorrectly, *under*-valued (i.e., valued too low). B?hm holds that there can be no doubt that this under-valuation exists. He attributes this to (1) lack of knowledge about our future needs, (2) indecision which, among other things, leads us to prefer present enjoyment to future enjoyment even when we know this choice is not in our overall welfare, and finally (3) the realization that life is both short and uncertain. All these factors operate in this direction.

These psychological factors, to which Böhm-Bawerk looks for an explanation of the *under*-valuation of future requirements, undoubtedly do exist. Moreover, they certainly can affect

human actions. They certainly play an important role in the decisions of many persons. Still?and Böhm-Bawerk recognized this?they affect different individuals to a very different extent and they affect the same individuals differently at different times when they are in different moods and humors. Böhm-Bawerk also noted that a tendency to *over*-value future goods may appear among those person who have fanatical fears for the future.

In discussing such psychological factors, we should keep in mind that they are not inexorably and universally true. We may assume, if we wish, that many men are regularly driven by the factors cited by Böhm-Bawerk to *under*-value future needs. But then we must also consider the effect of antithetical psychological factors which lead some to place *higher* valuations on future goods. We may, if we choose, disregard those persons who might be considered mentally disturbed misers and those with a fanatical fear of not having enough in the future. But then we must also disregard the opposite pathological types who give no thought at all to the future?the wild spenders, the simpletons too dull to conceive of any future worries and those who are depressed by the fear of some serious and imminent danger.

Some Persons Sacrifice for the Future

Still, we cannot overlook the fact that a higher valuation of the future may also play an important role in some human actions. The following typical cases come to mind: (1) the young man who turns down immediate employment at a moderate income and chooses present privation while training for work which promises a higher income later; (2) the saver or purchaser of insurance who foregoes present spending for current satisfaction in order to provide funds for his own or his family's future satisfaction; (3) the man who prefers a lower salaried position with pension benefits to a higher-salaried position without such future benefits; and (4) the entrepreneur who maintains a modest standard of living while plowing back a large part of his earnings into the business.

Capitalist savings and providing for the future through insurance are not always possible. Before there can be such savings, certain institutional conditions must exist. There must be established systems of banking, insurance, savings and loan organizations and, above all, a money free from inflationary influences. However, the fact that monetary savings cannot take place in the absence of such conditions, no more weakens the significance of these arguments concerning the reason for interest than does the fact that entrepreneurs and capitalists, threatened with expropriation, prefer to consume their capital rather than to surrender it to the expropriator. The truth is that wherever the institutional conditions necessary for financial savings have existed people have made ample use of them.

According to B?hm's second reason, people regularly prefer present goods to future goods because they (incorrectly) *under*-value *future* goods. Following this line of reasoning, one could say that the persons described in the examples cited above were (incorrectly) *under*-valuing *present* goods as against future goods, but that it is easy for them, after providing adequately for the present, to set aside something for the future which would otherwise be provided for less generously. However, there is no justification for this interpretation. Certainly this argument does not apply to the student preparing himself, at the cost of present self-denial, for a more lucrative future occupation. Nor does it apply to the young employee who works for a future pension, or to the other examples. None of these typical cases refers to persons who, in Böhm-Bawerks words, "are excessively well provided for in the present, or at least would be if they wished to consume completely in the present all the means currently available to them." (II:442, note #23) Rather they are persons who purposely reduce their

present standard of living in order to provide for a better future. They do this despite the fact that?from the viewpoint of their own subjective values?it represents present self-denial and renunciation.

Capitalism Encourages Persons to Save

As mentioned above, one may understand these things only by referring to observations made where social conditions permit the accumulation of monetary savings to provide for the future. The capitalistic economic order, inspired by the spirit of liberalism,[3] created conditions which permitted the development of thrift and thus, for the first time, offered the masses a choice between satisfying chronologically more immediate or more distant needs. Before then, saving had been restricted to the relatively small ranks of entrepreneurs and owners of real estate. Therefore, the tremendous increase in capital formation under capitalism has been, to a considerable extent, the result of the saving of the masses. However, despite the fact that capitalism provided the masses with a substantial increase in well-being, it certainly cannot be said that they have been so "excessively well provided for" that they *under*-valued present goods and thus found saving for the future easy.

Saving would certainly have become a much more widespread practice, even a mass mania, if two influences had not operated in the opposite direction: (1) the increasing threat to capital accumulation as a result of anticapitalistic tendencies and (2) the systematic derision of the practice of saving and the undermining of the value of saving, which came with the spread of an anti-capitalistic ideology. Liberalism recommended saving to the person of modest means as the only way to improve his future situation. Socialistic propaganda strove to demonstrate the opposite, namely that saving could never make individuals prosperous. According to the socialistic doctrine, capital arises?not from saving?but from the accumulation of profits produced by the exploitation of foreign labor and by the appropriation of surplus labor value.

One could surely find support for asserting that it may be a characteristic of the capitalistic economy to *over*-value future needs, rather than to *under*-value them as B?hm claims. However, such statements always concern psychological situations which lack inexorability and universality. Some persons are motivated to varying degrees by ideas which lead them to *under*-value future needs and the means for satisfying them. Others, however, *over*-value future needs and the means for satisfying them. A *universal* phenomenon, such as the *higher* valuation, as opposed to an *over*-valuation, of present goods and the *lower* valuation, as opposed to an *under*-valuation, of the same goods in the future can never be explained satisfactorily by the existence of psychological factors which affect different people differently.

Some Persons Expect a Brighter Future

Coming now to the *first reason* Böhm-Bawerk suggests for the higher valuation of present goods, namely that there are different ratios between want and provision at different periods of time. This attempt at an explanation is no more successful than his other. Here also the facts involved lack universality. Certainly, some persons endure privation in the present, hoping to be better provided for later. However, there are others, as B?hm also conceded, for whom the opposite holds true. In this latter category he included "a very considerable number of persons whose income is derived entirely, or in large part, from their personal activity and will therefore presumably cease in the later years of their lives when they become incapable of working." (II:266) In saying this, B?hm obviously intended to minimize the significance of

the fact that these people were in a position to retain present goods for use in the future, using them in the meantime as a reserve fund. These people would then value present goods no less than future goods and perhaps even somewhat more. Only in a dwindling minority of cases, wherein special circumstances impede or threaten any transfer from the present to the future, will present goods possess for their owners a smaller subjective use value than future goods. In such situations?even if there is no contributing influence other than the difference between supply and demand in present and future?the outcome of the subjective valuations which determine objective exchange values must obviously be such as to give present goods a powerful advantage, a considerable agio (premium) over future goods. (II:268)

Böhm-Bawerk did not recognize that the first reason he suggested for the greater valuation of present over future goods?that there are different ratios between demand and supply at different points in time?was rendered inconclusive by the fact that so many people actually *do* provide for the future, and not for the most immediate future only. The fact that the future is taken care of at all, the fact that present satisfaction actually is foregone to provide for the future, is proof that people expect that, in the absence of such precautions, the future would be inadequately provided for as compared with the present. It is irrelevant whether the number of persons who suffer want in the present while hoping to be more richly provisioned at a future time is larger or smaller. For, as B?hm realized, this group also divides into two sharply separated sub-groups:

(1) The first sub-group is made up of children and the sick, persons without present resources, for whom only the lapse of time can bring improvement. When they have grown, or are well once more, they will be able to work. In a society which lived from hand to mouth and, thus, was not familiar with credit transactions (the trading of present goods for future goods), such persons would be left to starve, unless protected by family loyalty or humanitarianism. However, in a society where provisions are being made for the future also, such persons, or their legal advisers or guardians acting on their behalf, can discount their future capacity to work and their anticipated future prosperity. In that way, today can be made more secure by reason of tomorrows expectations. They can do this only because other people are so well provided for in the present that they may provide now for their future, a future which, in their opinion, would otherwise be under-provisioned. This is still clearer with respect to the other sub-group.

(2) The second sub-group is composed of those who?in Böhm-Bawerk's words?"look forward with confidence to a career that will bring economic improvement." (II:266) These persons are preparing themselves for a calling, or taking preliminary steps in a profession, which promises to be remunerative only after some time. Such persons, who do not themselves have the means necessary to carry on during the training or waiting period, may arrange for a more distant future in this way because *other* persons *do* have these means available. These other persons lend out some of their present resources precisely because they, the lenders, being *relatively* over-provisioned in the present, may thus better provide for their own security in the future.

Only Savers Provide Choices Between Present and Future Goods

Differing ratios of demand to supply at various periods of time can explain why transactions being undertaken now take into consideration both the present and the future. However, these different ratios cannot explain why future goods are regularly valued *lower* than present goods. In the hypothetical case that future goods were to be valued as high or higher than

present goods, persons who were currently well provisioned would still, if they feared future deprivation, choose to set aside a part of their present goods for future needs. It is not surprising that persons who suffer want in the present, but hope to be better supplied in the future, are prepared to value present goods higher than future goods. However, it is not they who play the decisive role on the market where present goods are exchanged against future goods. The significant role devolves on those who actually have at their disposal present goods, some of which they can decide to use for immediate satisfaction or for more distant future wants. It is they who choose between present and future goods. It is as a result of *their* choices that the differences in value appear which lead to the problem we are trying to explain.

All Consumers Prefer Present Goods

Böhm-Bawerk's error consisted primarily in the fact that be sought to base the theory of the higher valuation of present goods on psychological grounds. However, a universally true theory may never be attained via psychological paths. Psychology can show us that *some* persons, or even *many* persons, are guided by certain influences. But psychology can *never* demonstrate that a definite conduct is necessarily always and in the same way common to all men.

As a matter of fact, what Böhm-Bawerk actually succeeds in demonstrating is only that it appears plausible for men to place higher values on *present* goods than future goods under *some* circumstances, while under *other* circumstances it appears no less plausible for the opposite to be true, i.e., for *future* goods to be more highly valued than present goods. What Böhm-Bawerk's thesis comes down to then is that some types of persons are inclined toward an incorrect *under*-valuation of future goods, while others lean toward an incorrect overvaluation of future goods.

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Böhm-Bawerk therefore merely arrived at the conclusion that "as a rule" future goods have a lower value than the same kind and quantity of present goods. But that is not a satisfactory explanation. Are there exceptions to this rule? If there are, what significance do they have for explaining interest? Might the exceptions not become the rule under certain circumstances and interest than disappear entirely?

No, there are no such exceptions In acting, one must always, without any exception, value a satisfaction at an earlier point in time more than the same kind and amount of satisfaction at a later time. If this were not so, then it would never be possible to decide in favor of a present satisfaction. Whoever uses or consumes anything, whoever seeks by acting to relieve to a greater or lesser extent a felt uneasiness is always expressing a preference for an earlier over a later satisfaction. Whoever eats and consumes anything is making a choice between a satisfaction in the immediate future and one in a more distant future. If he were to decide differently, if he were not to prefer the earlier to the later satisfaction, he would never be able to consume at all. He could not even eat and consume tomorrow, because when tomorrow became today, and the day after tomorrow became tomorrow, the decision to consume would still call for valuing an earlier satisfaction more than a later satisfaction. Otherwise, consumption would have to be delayed still further.

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[1] *See Böhm-Bawerk, Eugen. *Capital and Interest*. 3 volumes. English translation from the German 4th edition (South Holland, Ill.: Libertarian Press, 1959). This section discussed here appears in Volume II, pp. 259 ff. Page citations in this translation are to this edition and volume.

[2]Mises discusses Böhm-Bawerk's first reason below, immediately following this critique of his second reason. BBG.

[3]See "Liberal," sense (1), above pp. 79-80.